

Revenue Review

Tennessee Department of Revenue

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REVENUE ...
Working For You



July 2005

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Visit our Web site to subscribe to Revenue-News or lists dedicated to county clerks and city officials.

Contact Us:

Tennessee Department of Revenue
Attn: Taxpayer Services
500 Deaderick Street
Nashville, TN 37242
(615) 253-0600
Statewide toll-free:
(800) 342-1003

2005 Legislative Changes

The Department of Revenue tracked 260 bills during the 2005 session which ended on May 28, 2005. Numerous tax law changes were made during this session. A complete Legislative Summary listing is available on the department's Web site at www.Tennessee.gov/revenue. A complete copy of the public chapters may be found at www.state.tn.us/sos. Summaries of broader interest are included below.

Sales and Use Tax Legislation

Streamlined Sales and Use Tax Update

The effective date of Tennessee's legislation to conform to the provisions of the Streamlined Sales and Use Tax Agreement (SSUTA) has been delayed until **July 1, 2007**. The legislation which delays implementation of these law changes also designates a group to study the effects of law changes on local governments and small businesses, and requires the group to report their findings to the Senate and House Finance, Ways and Means Committees by Dec. 31, 2006. *Public Chapter 311*. A comprehensive discussion of Tennessee's Streamlined law changes was included in the April 2005 *Revenue Review*, and additional information may be found on the department's Web site at www.Tennessee.gov/revenue.

At the national level, the SSUTA was amended in April 2005 to allow states such as Tennessee to be associate members of the Streamlined Governing Board as long as the effective date of their conforming legislation is on or before Dec. 31, 2007. Tennessee's application for associate membership will be voted on by other streamlined states on July 1, 2005.

Other Sales and Use Tax Updates

Electronic Filing: TCA § 67-1-703(b) requires taxpayers whose average monthly sales and use tax liability is \$10,000 or more to make payment in readily available funds. In 2002, it became mandatory to file sales and use tax returns electronically if a taxpayer was required to pay its sales and use tax in readily available funds. Electronic filing of these returns reduced errors and lowered the processing costs. Effective May 4, the requirement to file electronically and pay in readily available funds applies to any taxpayer whose average monthly tax liability exceeds \$5,000. *Public Chapter 131*. Taxpayers who meet this

new threshold will be contacted by the Department of Revenue's Taxpayer Services Division to make arrangements for electronic filing and payment in readily available funds. Many taxpayers are already taking advantage of the ease and simplicity of electronic filing.

Sales Tax Holiday Beginning in August 2006:

Tennessee will have an annual sales tax holiday that starts each year at 12:01 a.m. on the first Friday in August and ends at 11:59 p.m. on the following Sunday. During the holiday, the following items are exempt from sales tax: 1) clothing with a price of \$100 or less per item; 2) school supplies with a price of \$100 or less per item; and 3) computers with a price of \$1,500 or less per item. The following are specifically excluded from the exemption: computer software, clothing accessories, protective equipment, sports and recreational equipment, school art supplies, school instructional material, and school computer supplies. The exemption does not apply to items used in a trade or business or to items that are rented. The new law also contains administrative provisions. The department will provide more detailed information to businesses as the date of the first holiday approaches. *Public Chapter 398*.

Food Service Establishments: The department has received correspondence from certain food service establishments inquiring whether they qualify as manufacturers. Legislation was passed that specifically addresses the department's long-standing policy that fast-food restaurants and pizza delivery companies do not qualify as manufacturers for sales tax purposes. *Public Chapter 499*.

Qualified Headquarters Credit: The expiration date of 12/31/06 on the credit available for establishing a qualified headquarters facility in the state of Tennessee pursuant to TCA § 67-6-224 has been removed. *Public Chapter 499*.

Contractor's Use Tax: An exemption from contractor's use tax is available for tangible personal property that is provided to a contractor on a temporary basis to be tested provided that the testing facility is owned by the United States or any agency thereof. The exemption does not apply to property consumed or destroyed during the test. "Testing" is limited to diagnostic, analytical and/or scientific testing in a controlled environment dedicated to such testing for the purpose of providing information and findings supportive of the aerodynamic, hypersonic, aero propulsion, space, missile, aircraft and aerospace technologies and/or industries. *Public Chapter 371*.

Sales and Use Tax Legislation, *continued*

Animal Grooming Charges: Charges for bathing and grooming animals are subject to sales tax based on 100% of the charges for such services. Bathing of animals by veterinarians for medical purposes remains exempt from sales tax. *Public Chapter 499.*

Recordkeeping: Tennessee law requires all dealers to preserve suitable records of all sales and purchases and to maintain adequate books of account for three years. TCA § 67-6-523 has been amended to clarify that the three-year period runs from Dec. 31 of the year in which the associated sales and use tax return was filed. *Public Chapter 499.*

Franchise Tax and Excise Tax Legislation

Decoupling from American Jobs Creation Act: Tennessee has decoupled from a provision of the 2004 American Jobs Creation Act (P.L. 108-357) that allows a deduction from federal taxes for a specified portion of "Qualified Production Activity Income." The new law requires that any deduction taken pursuant to 26 U.S.C. § 199 to be added back to the taxpayer's net earnings for Tennessee excise tax purposes. *Public Chapter 499.*

New Definition for Affiliate: A technical correction throughout the franchise and excise tax laws was made to adopt and refer to a uniform definition of affiliate which means any entity:

(A) In which the taxpayer, directly or indirectly, has more than 50% ownership interest;

(B) That, directly or indirectly, has more than 50% ownership interest in the taxpayer; or

(C) In which an entity described in subdivision (1)(B) directly or indirectly has more than 50% ownership interest.

Public Chapter 499.

Clarification of Franchise and Excise Tax Exemption Relating to Tiered Entities: As a general rule, Tennessee imposes franchise and excise taxes on all entities that provide limited liability protection to the owners. However, an exemption from such taxation is provided to limited liability companies, limited partnerships and limited liability partnerships all of whose members or partners have elected to be fully liable for the debts, obligations, and liabilities of the entity and that have filed the appropriate documentation with the secretary of state. It has come to the department's attention that a number of tax planning techniques have been employed by limited liability entities to avoid the application of franchise and excise taxes while still providing limited liability protection to the owners or partners of these entities. In order to address these issues, TCA § 67-4-2008(a)(9) has been amended to delete the current exemption. Going forward, Tennessee will allow the members or partners of a limited liability entity to make an election for the entity to be treated as an exempt "obligated member entity." The members or partners making this election must file the required documentation with the secretary of state to become fully liable for the debts, obligations, and liabilities of the entity. Such members or partners are referred to as "obligated members." In the event that any obligated member or any owner of an obligated member, whether such ownership is in whole, in part, direct or

indirect, provides limited liability protection, the obligated member entity is liable for franchise and excise taxes on the portion of income and equity attributable to such obligated member. *Public Chapter 499.*

Partial Year Returns: For franchise tax purposes, TCA § 67-4-2115 has been amended to allow for proration of franchise tax in two instances: 1) if the tax year is closed within less than 12 months of incorporation, domestication or commencement of business in Tennessee; and 2) if the taxpayer changes its accounting period covered by the federal return. No other proration of franchise tax will be permitted. Consistent with existing departmental policy, TCA § 67-4-2015 has also been amended to state that there is no proration of excise tax for a return that covers a period of less than 12 months. *Public Chapter 499.*

New Deduction for Qualified Charitable Donations:

Legislation was passed enacting a new deduction from net earnings for excise tax purposes equal to 75% of the amount donated to nonprofit organizations exempt from federal tax under 26 U.S.C §§ 501(c)(3) - (6). The nonprofit organization must certify to the entity taking the deduction that the donated funds were spent on goods or services subject to sales and use tax. Adequate records must be maintained to support the transactions. *Public Chapter 98.* Effective date: Tax periods on or after 7/1/2005. This deduction is similar to the deduction passed in 2004 for donations to qualified public school support groups set forth in TCA § 67-4-2006(b)(2)(N).

The department is preparing guidelines for administration of this new deduction. These guidelines should be available on the department's Web site by early September 2005.

Other Tax Legislation

Hall Income Tax: A taxpayer will be granted an automatic six-month extension of time in which to file a Hall income tax return provided that a copy of the taxpayer's written extension request is attached to the tax return filed on or before the extended due date of the return. Taxpayers do not need to file a request for extension separate from the tax return. Taxpayers may use either an extension form from the Department of Revenue or the taxpayer's federal request for extension filed for the corresponding tax period. *Public Chapter 499.*

Refund Procedures: TCA § 67-1-1802 has been amended to require that a claim for refund be filed with the commissioner under penalty of perjury. The claim must set forth each ground upon which a refund is claimed, the amount of the refund, the tax period, the tax type and information reasonably sufficient to apprise the commissioner of the basis for the claim. A refund requested on a properly filed franchise and excise tax return is deemed to comply with these requirements.

TCA § 67-1-801 has been amended to clarify the provisions for the accrual of interest on refund claims that are determined either by administrative review or determined to be due by court order. *Public Chapter 499.*

Other Tax Legislation, *continued*

Gift Tax: Distributions from college savings plans are exempt from gift tax regardless of whether they are Tennessee BEST plans or out-of-state plans. *Public Chapter 499.*

Litter Tax: The gross receipts tax earmarked to fund programs for the prevention and collection of litter that applies to bottles of soft drinks (extra 0.4%) and barrels of beer (extra \$0.50 per barrel tax) has been extended until June 30, 2010. *Public Chapter 86.*

A Taxpayer and Its Affiliated Group Members May Compute Net Worth For Franchise Tax Purposes on a Consolidated Basis

For tax years beginning on or after Jan. 1, 2004, a taxpayer that is a member of an affiliated group may elect to compute its net worth for franchise tax purposes on a consolidated basis, provided that each affiliated group member also makes such an election. Members who join the group are bound by the group's election. Forms for making this election and for computation of consolidated net worth for franchise tax purposes may be obtained from the Department of Revenue and are available on the department's Web site at www.Tennessee.gov/revenue.

An application for computation of net worth on a consolidated basis must be submitted to the department no later than the original due date of the return for the tax year. For example, a return for the calendar year 2005 is due April 15, 2006, and election to compute net worth on a consolidated basis for that year must be made no later than that date. Once made, the election remains in effect for a five-year minimum. After the initial five years, the consolidated net worth computation election will continue unless discontinued in writing by the affiliated group.

However, a transition period runs through Dec. 31, 2006. During the transition period, the Department of Revenue will accept late elections for consolidated net worth computation or for revocation of such an election. Thus, notwithstanding the mandatory five-year period, during the transition period an affiliated group can make a one-time change in its election to compute net worth on a consolidated basis.

If an affiliated group does not elect to compute net worth on a consolidated basis, none of its members may deduct any stock or interest held in an entity doing business in Tennessee when computing their net worth franchise tax base. The statute allowing such a deduction has been repealed effective for tax years beginning on or after Jan. 1, 2004.

Computation of franchise tax on consolidated basis, *cont'd*

Depreciation Deductions for Excise Tax Purposes

When computing net earnings for excise tax purposes, depreciation computed under the bonus method and deducted for federal income tax purposes must be added back. This is done on Line 2 of Schedule J of the return form. Depreciation for excise tax purposes must be computed using the MACRS federal depreciation method as required prior to Sept. 11, 2001. Depreciation so computed is deducted on Line 13 of Schedule J.

IRC § 179 and Contribution Deductions on Federal 1065, Schedule K

When computing a partnership's net earnings for excise tax purposes, amounts shown in the federal 1065, Schedule K "Income (Loss)" section must be added at Line 2, Schedule J-1 of the Tennessee franchise, excise tax return. Amounts, including IRC Section 179 and contributions passed through to shareholder partners, shown in the "Deductions" section of federal 1065, Schedule K must be deducted on Line 5, Schedule J-1 of the Tennessee franchise, excise tax return. Amounts shown in the "Self-Employment" section of federal form 1065, Schedule K are deducted on Line 6 of Schedule J-1 of the Tennessee franchise, excise tax return.

Information Exchange Program Increases Use Tax Compliance

Tennessee businesses and individuals are responsible for paying use tax on items they have imported into Tennessee without payment of sales tax to the seller. This includes merchandise that is purchased out-of-state, online or through catalogs.

In order to identify merchandise imported into Tennessee without the payment of sales tax, the department participates in information exchange programs with other states and federal agencies. One such program is the Southeastern Association of Tax Administrators (SEATA). SEATA member states include most of Tennessee's border states (Kentucky, Arkansas, Mississippi, Alabama, Georgia, North Carolina and Virginia) plus Florida, Louisiana, South Carolina and West Virginia. Member states collect and exchange audited sales and purchase information on behalf of other member states so that use tax can be properly collected from the customer. For example, if a company is audited in Kentucky and their books and records indicate sales were made in Tennessee, then the Kentucky Department of Revenue notifies Tennessee. Tennessee reciprocates and provides information obtain from its audits to other member states. Through this reciprocal sharing of SEATA information, Tennessee has assessed and collected more than \$29 million since joining in 1989.

Additional information about use tax is available on our Web site, www.Tennessee.gov/revenue. Additional information about SEATA is available at www.seatastates.org.

Save the Date: Upcoming Seminars and New Business Workshops Across the State

Visit our Web site, www.Tennessee.gov/revenue, and click on "Seminars, New Business Workshops and Speakers" to learn more about these and other upcoming seminars and workshops.

July

July 13 – New Business Workshop, Chattanooga

July 13 – New Business Workshop, Knoxville

July 13 – Tennessee Business Taxes, Austin Peay State University, Clarksville

July 14 – New Business Workshop, Johnson City

July 14 – New Business Workshop, Memphis

July 14 – Tennessee Business Tax, University of Tennessee, Knoxville

July 19 – Tennessee Business Tax, University of Tennessee at Chattanooga, Chattanooga

July 21 – Tennessee Business Tax, Doubletree Hotel (Middle Tennessee State University), Murfreesboro

July 26 – New Business Workshop, Nashville

July 27 – Tennessee Business Taxes, The Centre at Millennium Park (East Tennessee State University), Johnson City

July 29 – Tennessee Business Taxes, University of Memphis, Memphis

September

Sept. 8 – New Business Workshop, Johnson City

Sept. 8 – New Business Workshop, Memphis

Sept. 14 – New Business Workshop, Chattanooga

Sept. 21 – New Business Workshop, Knoxville

Sept. 27 – New Business Workshop, Nashville

Did You Know...

Tax collections and statistics are a click away on Revenue's Web site? Go to www.Tennessee.gov/revenue and click on "Tax Collections and Statistics" to access the figures.

Speakers Bureau

The Department of Revenue offers a speakers bureau. Professionals from across the state are available at no charge for professional groups, civic clubs, special events and academic organizations in Tennessee. Speakers are available to present on a variety of topics, from Streamlined Sales Tax and franchise and excise taxes to inheritance and gift taxes.

Call (615) 741-2461, e-mail emily.richard@state.tn.us, or write to Emily Richard, Tennessee Department of Revenue, 500 Deaderick Street, Suite 1200, Nashville, TN 37242, to request a speaker. Requesting agencies/organizations should contact the department at least two weeks in advance and provide the following information.

- Date and time speaker needed
- Name of group requesting speaker
- Location
- Topic
- Desired length of presentation
- Number of people expected to attend presentation
- Contact name, address, phone number and e-mail address

Contact Us

- Taxpayer hot line: Statewide toll-free (800) 342-1003; Nashville-area and out-of-state callers should call (615) 253-0600.
- Online tax help by e-mailing TN.Revenue@state.tn.us.
- Streamlined Sales Tax hot line: In Tennessee, call (877) 250-2299. In Nashville and outside Tennessee, call (615) 253-0752.
- Streamlined Sales Tax online assistance by e-mailing Streamlined.Salestax.QandA@state.tn.us.
- Tax practitioner hot line: Statewide toll-free (800) 387-8395; Nashville-area and out-of-state callers should call (615) 253-0700.
- Local government hot line: (866) 562-2549.
- E-mail updates: Visit our Web site, www.Tennessee.gov/revenue, to subscribe to Revenue-News or lists dedicated to county clerks and city officials.
- Electronic commerce hot line: Statewide toll-free: (866) 368-6374. Nashville-area and out-of-state callers should dial (615) 253-0704.
- Tax fraud hot line: To report tax fraud, call (800) FRAUDTX (372-8389).

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